



www.21Academy.education

Law for Directors & Managers

Lecture 8

Officers of the Company

-

Part 2

CAMILLERI PREZIOSI
— ADVOCATES —

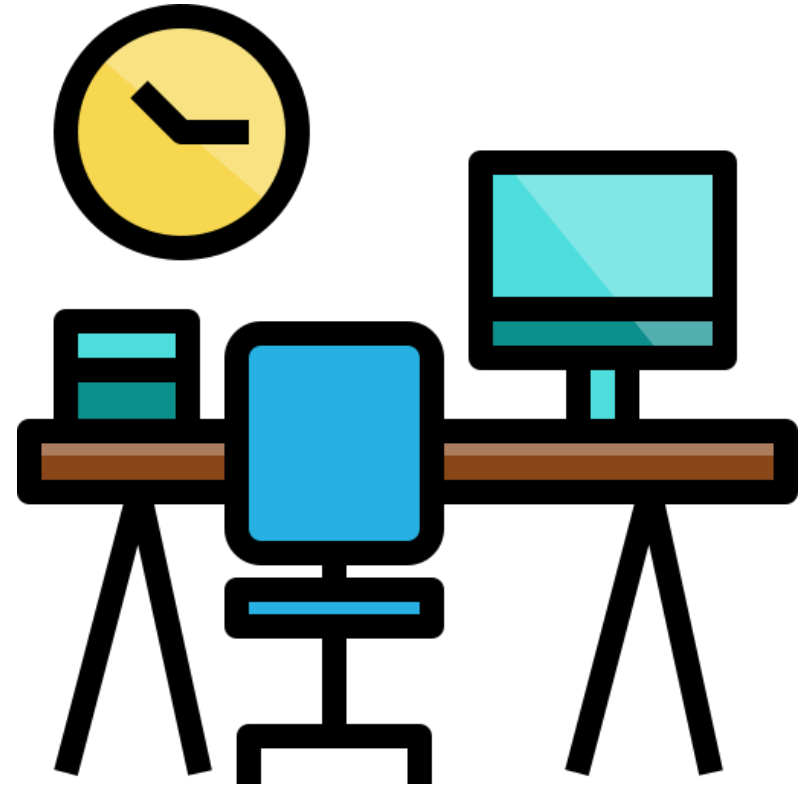


www.21Academy.education

Introduction

It is very common for the board of directors to have extremely broad discretionary powers in relation to their conduct of the business of the company.

- Conferring a broad discretion however, increases the risk that the powers are misused or are exercised for purposes other than those for which they would have been granted, and especially increases the risk that the powers are exercised in the interests of the directors themselves.



The Principle of 'Reserved Powers'

The directors may exercise all powers of the company which are not required to be exercised by the shareholders in general meeting, by the Companies Act or the Memorandum and Articles of Association.

Delegation of Powers

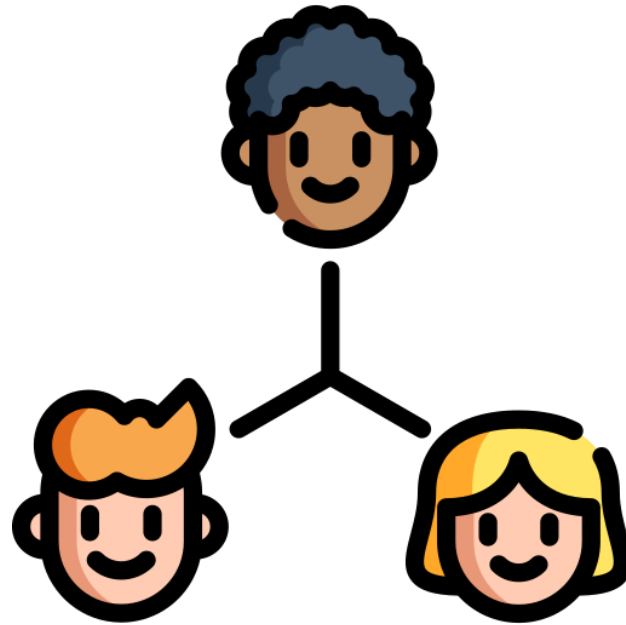
- The BOD may delegate its powers to a director acting singly, to sub-committees or even to other individuals.
- Practically speaking, this delegation may take place by way of a separate agreement (preferably written) or by way of a written resolution.
- The most important issue to keep in mind is that the board may not delegate unless it is expressly empowered to do so by the MAs of the company.
- This restriction is found in the principle of '*delegatus non potest delegare*', and the legal institute known as mandate: as mandataries of the company, directors must act in accordance with the mandate granted to them by the company.

Juridical character of directors



The juridical character of the director under Maltese law should be assessed by reference to general principles of Maltese law itself.

Duties of Directors



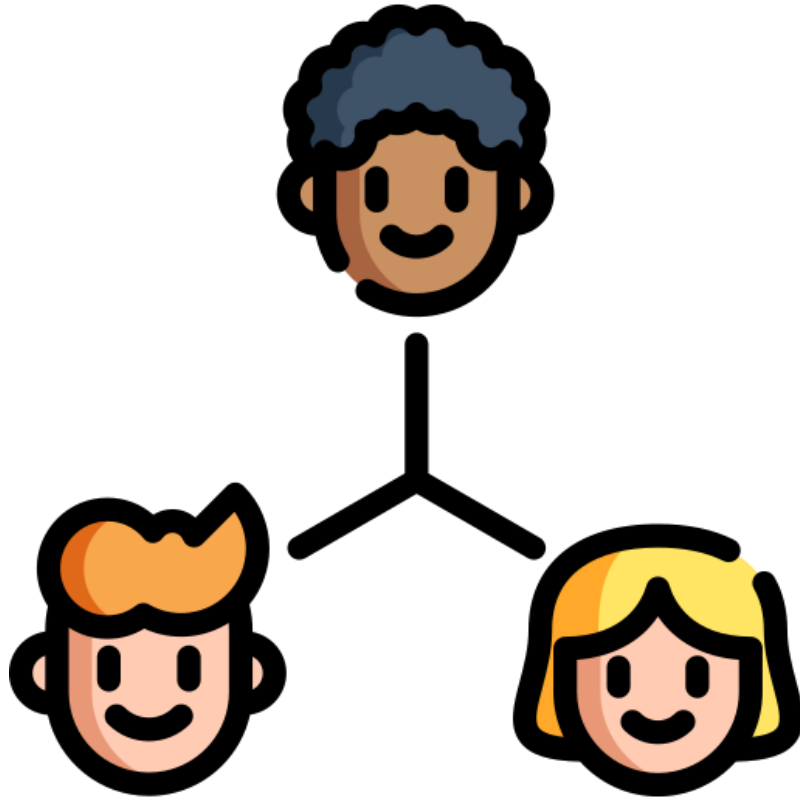
Duties of Directors

The general rule is that the directors **owe their duties to the company, and not the individual shareholders.**

The directors are mandataries and fiduciaries of the company. They are obliged to act in the best interests of the company and to promote its well-being.

A director may, in certain circumstances, also be personally liable in tort toward third parties.

Duties of Directors



1. Duties of a general nature
2. Specific duties
3. Duties of care and skill
4. Duties qua mandatory
5. Duties qua fiduciary
6. Special duties

1. Duties of a general nature

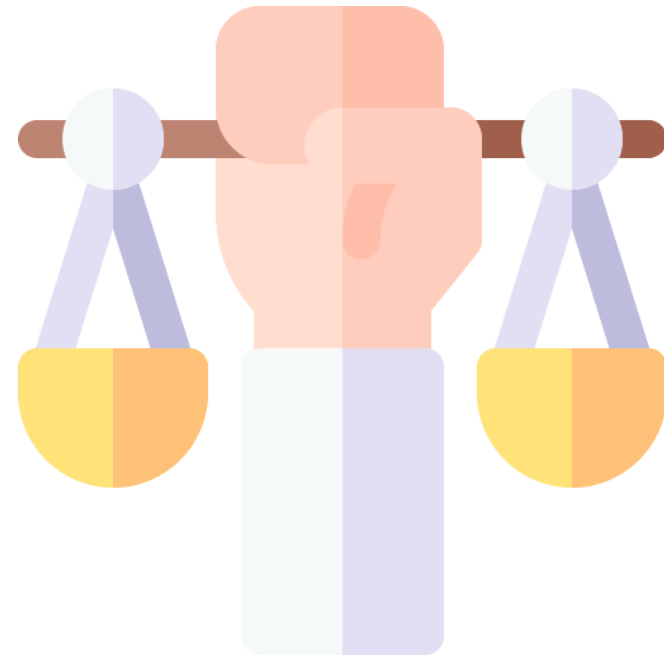
These are those stated under the CA or which arise out of the juridical nature of directors under general principles of law.

Broadly speaking, directors are expressly bound to **act honestly and in good faith** and in the **interest of the company**, to promote its **well-being**, to exercise **due care, diligence** and **skill** and **not to engage in self-dealing** and **not to misuse their powers**.

1. Duties of a general nature

Article 136A(1) – “to act honestly and in good faith in the best interests of the company”

- It is the directors’ subjective opinion as to the interests of the corporators as a general body, balancing the short-term interests of the present members against the long-term interests of future members, which counts.
- Directors are required to act *bona fide* in what they consider, and not what a court may consider, is in the interests of the company.
- ‘*in the interests of the company*’ means the interests of the members, and in exercising their powers, directors must act primarily in the interests of the members of the company as a whole.
- The duty to act in the best interests of the company normally requires the directors to treat all shareholders equally.
- Where a director is appointed as a nominee of a particular shareholder or class of shareholders, his overriding responsibility remains to the company as a whole



1. Duties of a general nature



Article 136A(3)(e) – directors must exercise their powers for the purposes for which such powers were conferred and not misuse such powers.

- The directors are bound to observe any limitation on their powers, whether such limitation arises from the Companies Act or from the Memorandum and articles. The CA may well specify the consequences of failure to abide by the relevant rules.
- Directors must not do any act or enter into any transaction which is illegal or *ultra vires* the company's objects and they must not, without the sanction of the general meeting, do any act or enter into any transaction which is beyond the powers conferred on directors by the articles.
- Even if the directors act honestly for what they believed to be in the interest of the company, they may still be liable for breach of duty if they exercise their powers for a purpose different from that for which the powers would have been conferred upon them. This applies to directors in any of their powers.

Punt vs. Symons & Co. Ltd (1903)

Facts:

- The articles of association gave the governing director the power to appoint and remove directors, and after his death the same power was exercisable by his executors.
- After the death of the governing director, friction arose among his executors and the directors, leading to a proposal by the directors to rescind the articles in question by a special resolution.
- In order to secure the passing of the resolution, the directors issued new shares to five additional members.
- At the request of the executors, an injunction was granted to prevent the company from holding the meeting.
- The issuing of the new shares to the additional members was held to be an abuse of the powers of the directors.

Decision:

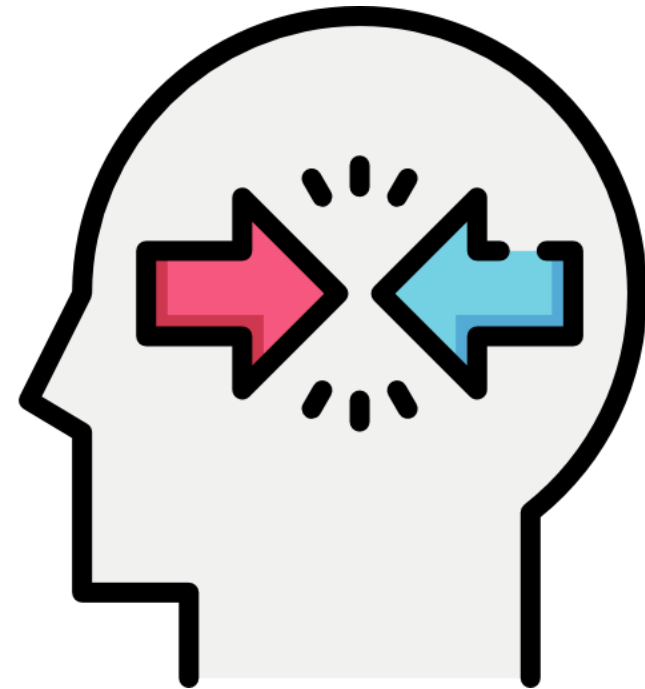
- In the Court's view, the meaning, object and intention of the issue of the shares was to enable the shareholders holding the smaller amount of shares to control the holders of a very considerable majority.



1. Duties of a general nature

No conflict of duty and interest

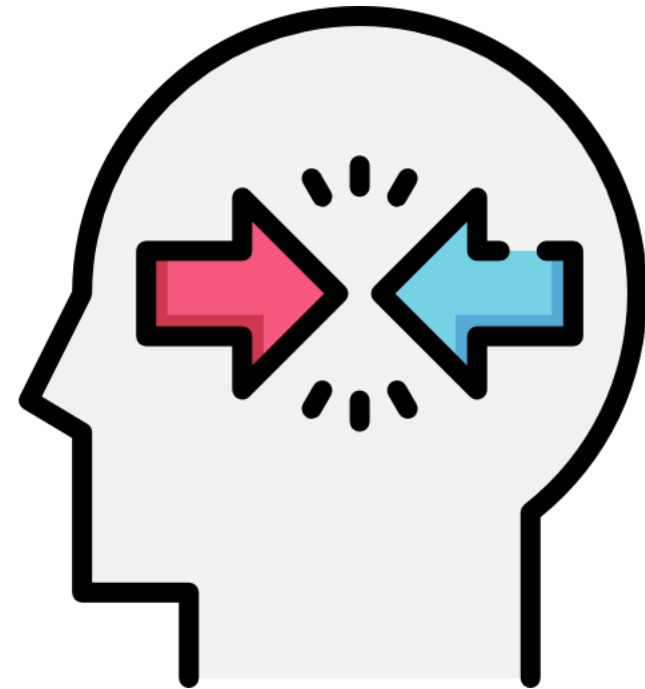
- The rule of no interests requires directors not to profit from their position unless otherwise entitled.
- Directors should not place themselves in a position where there is a conflict between their duties to the company and their personal interests or duties to others.
- Art.145 of the Companies Act requires every director to declare the nature of his interest to the other directors, and if a director fails to comply with this provision, he/she will be liable to a penalty.
- Directors shall not use any property, information or opportunity of the company for their own or anyone else's benefit, nor obtain benefit in any other way in connection with the exercise of their powers except with the consent of the company in general meeting or as otherwise permitted in the company's memorandum/articles of association.



1. Duties of a general nature

No conflict of duty and interest

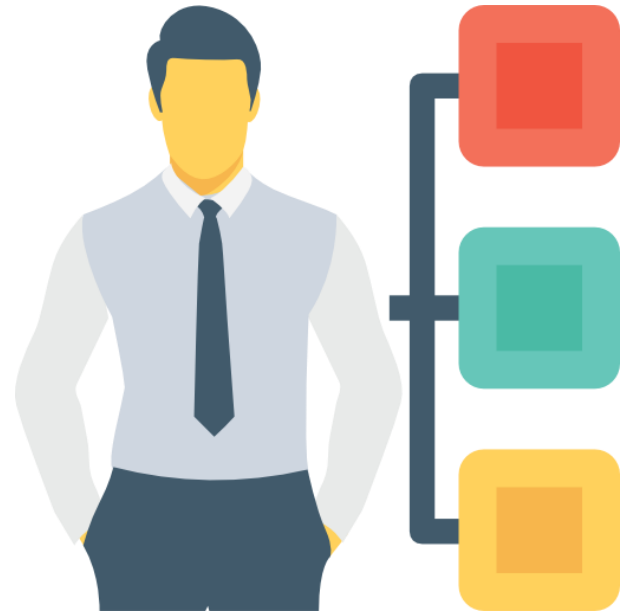
- Art.145 gives rise to the question as to whether the company can choose to enter into the transaction notwithstanding the director's interest in the matter; and the answer is **yes**.
- Were the law to provide otherwise, a company would be unnecessarily deprived of a choice of contracting parties.
- Another question it gives rise to is whether the director can vote on the transaction, and this **depends on the articles of association**.
- The model articles in the First Schedule provide that a director *"shall not vote at a meeting of the directors in respect of any contract or arrangement in which he is interested, and if he shall do so his vote shall not be counted, nor shall he be counted in the quorum present at the meeting."*
- The subscribers to the M&As however, are free to allow a director to vote on a proposed transaction notwithstanding his interest (this without prejudice to the obligation of the director to declare his interest)



1. Duties of a general nature

Not to compete with the company

- Art.143(1) says that “a director of a company may not, in competition with the company and **without the approval of the same company given at a general meeting**, carry on business on his own account or on account of others, nor may he be a partner with unlimited liability in another partnership or a director of a company which is in competition with that company.”
- A breach of this article may give the company an option of either taking action for damages and interest against the director or demand payment of any profits made by him in contravention of the rule. Moreover, a breach by a director of Article 143(1) need not necessarily cause the company to suffer actual damages.
- The CA does **not** prohibit a director of a company from holding shares in a competing company. As long as the director’s interest is merely that of a member of the competing company and is not on the board of such company, no serious conflict of interest or duty should arise.
 - moreover, the mere holder of shares should not, *per se*, have access to confidential information of the competing company or be involved in the management or decision taking process.



1. Duties of a general nature

Art.144(1)(a) - Prohibition of loans, guarantees, provision of security and compensation for loss of office

- This however does not apply:
 - (a) when such loan etc., with the approval of the company in a general meeting, is given to the director in order to provide him with sufficient funds that he himself incurred for purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company; and
 - (b) when the company's ordinary business is that of lending money or giving guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business.
- Art.144(1) also prohibits a company from making any payment to any director by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, unless particulars with respect to the proposed payment are disclosed to members of the company and the proposal is approved by the company in general meeting.
- Although the prohibitions extend to the directors (and shadow directors) of the company's parent company, it would appear that a parent company may make a loan or give guarantees or provide security to directors of its subsidiary companies.

** none of the prohibitions contained in art.144(1) apply to a private exempt company.*



1. Duties of a general nature



Unfettered discretion

- Even in the absence of an express provision in the law, it would appear that as a general principle, directors cannot validly contract, either with another or with third parties, as to how they will vote at future board meetings or how they will otherwise conduct themselves in the future – even if there is no improper motive or purpose and even if no personal advantage is to be gained by the directors under the agreement.

2. Specific duties

Duties relating to the keeping of statutory registers and minute books



The Companies Act requires that every company should keep a register of members and a register of debentures. A company is also required to keep minutes of board and general meeting and to keep minute books for this purpose.

Duties relating to the filing of returns and documents



The Companies Act requires that a variety of returns and documents be prepared and filed with the Registrar of Companies. These duties are generally imposed by the act on all officers of the company. In practice however these duties are performed by the company secretary.

Duties relating to board and general meetings



Certain responsibilities in relation to meetings are also incumbent on directors. General meetings are usually summoned by directors. Moreover, the directors are obliged, on the requisition of a member of the company holding at the date of the deposit of the requisition not less than 1/10 of such of the paid up share capital of the company as at the date of the deposit carried the right of voting at general meetings of the company, to forthwith proceed to duly convene an extraordinary general meeting of the company.

2. Specific duties

Duties relating to record keeping and financial statements



The directors of every company must prepare individual accounts for each accounting period. As a general rule, the directors are obliged to ensure that the accounts are drawn up clearly and in accordance with the provisions of the Act and the generally accepted principles. Furthermore, directors need to exercise considerable caution in relation to the approval of the annual accounts.

Every director at the time the accounts were approved is to be considered as a party to their approval unless he proves that he took all the reasonable steps to prevent their being approved.

Also, the directors are required to prepare a report in respect of each accounting period, in order to review the progress of the company's business; this is called a Director's Report, and this will note any significant changes, and any risks and uncertainties.

Duties relating to the liquidation of the company



Once a company is dissolved and a liquidator is appointed all the powers of the directors will cease. The only power that appears to be retained by directors is in relation to meetings of the creditors and contributories which are to be summoned by the liquidator.

2. Specific duties

Miscellaneous duties

Article 82(1) of the CA empower each of the directors to authenticate documentation of the company. Furthermore, a company is obliged to issue share certificates within specified time periods listed down in Article 120(1) of the Companies Act. The latter is often signed by one of the directors.

Other specific duties arising from 3 different pieces of legislation:

1. Duties that are found in the **Listing Rules**
2. Duties that are found in the **Code of Principles of Good Corporate Governance**
3. Duties which arise from the **Prevention of Financial Markets Abuse Act**

3. Duties of care and skill

Art.136A(3) specifically obliges directors to exercise “the degree of care, diligence and skill which would be exercised by a reasonable diligent person having both

- i. knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and***
- ii. the knowledge, skill and experience that the director has.”***

- This provision establishes both an objective and a subjective standard by which a director is to be judged in the exercise of his duties of care, diligence and skill.

4. Duties qua mandatary

Duties of a mandatary which can be considered to be applicable to directors:

1. **Carrying out the mandate so long as the mandatary is vested therewith.** In the case of non-performance of such duty, the mandatary is answerable for damages and interest.
2. Another duty applicable to directors is that **the mandatary is bound to render his mandator an account of his management and of everything that he has received by virtue of the mandate;** even if what he has received was not due to the mandator.
3. The mandatary must **not delegate his authority by substituting another person for himself, unless he has been empowered to do so by his mandator.**

5. Duties qua fiduciary

Directors can also be regarded as fiduciaries; and a 'fiduciary' is defined as a person who:

- (a) Owes a duty to protect the interests of another person;
- (b) holds, exercises control or powers of disposition over property for the benefit of other persons, including when he is vested with ownership of such property; or
- (c) receives information from another person subject to a duty of confidentiality and such person is aware or ought, in the circumstances, reasonably to have been aware, that the use of such information is intended to be restricted.

A director falls under the first limb of this definition and may also qualify as a fiduciary under the second and third points.

- This duty of good faith and honesty cannot be excluded by contrary agreement.

Duties of Directors of Listed Entities



Duties of Directors of Listed Entities

A director sitting on a board of a company that has its securities admitted to listing has a number of additional obligations to comply with. Principally, one must meet continuing disclosure requirements, including:

- (A) Company Announcements**
- (B) Related Party Transactions**
- (C) Dealing in Securities**
- (D) Prevention of Financial Markets Abuse Act**

(A) COMPANY ANNOUNCEMENTS

The Listing Rules provide for a variety of instances in which a company announcement is to be made, including:

- Price sensitive facts which are not public knowledge (inside information);
- Date of meeting at which dividend is to be proposed by the directors;
- Planned mergers, amalgamations, disposals or acquisitions; and material changes to capital structure.



(B) RELATED PARTY TRANSACTIONS

Care must be taken with respect to the effect of related party transactions on the financial position and performance of the company.

Generally, a related party transaction is a transaction between a company and any person who has the ability to directly or indirectly control the company or exercise significant influence over the company in the making of financial and operating decisions.

This may include:

- Two entities having a director (or other key senior personnel) in common
- A transaction with a customer/supplier with whom an entity transacts a significant volume of business, merely by virtue of the underlying economic dependence



(C) DEALING IN SECURITIES

The general rule is that:

- You must never deal in those securities if you are in possession of price-sensitive information which has not been disclosed.
- You should establish policies to guide directors in how/when they trade in such securities.
- Furthermore, you have an obligation to give advanced notice in writing to the Chairman if you intend to deal directly/indirectly in such listed securities.



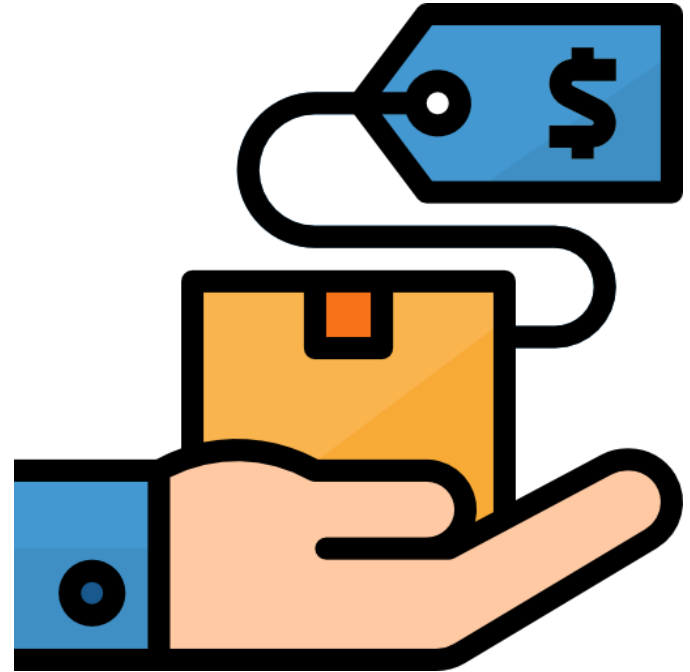
(D) PREVENTION OF FINANCIAL MARKETS

~~ABUSE ACT~~

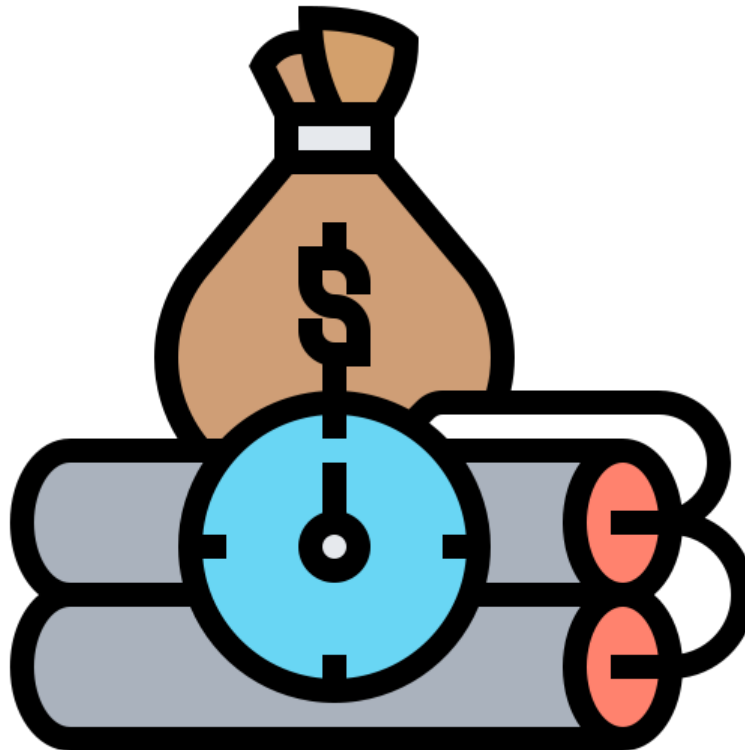
The **Prevention of Financial Markets Abuse Act (the “Act”)** (Cap. 476) imposes additional obligations on directors in view of the fact that directors are automatically deemed to be persons in position of Inside Information.

This act prohibits:

- Insider dealing;
- Unlawful disclosure of inside information; and
- Manipulative market practices



— Joint and several liability of directors



No distinction between executive and non-executive directors

The Companies Act makes no distinction between executive and non-executive directors. Accordingly, from a *prima facie* reading of the law, it is arguable that the liability that may be imposed on directors is equal irrespective of whether ones role is executive or non-executive in nature.

Taking the law as it is, one concludes that their duties and liabilities are the same regardless of whether they have a managerial or supervisory role, and be they independent or otherwise.

Joint and Several Liability of Directors for breach of duty

The general principle under the Companies Act is that the personal liability of the directors for any breach of duty is joint and several.

However, there are exceptions to this rule:

1. Where a particular duty has been entrusted to one or more of the directors, only such director or directors is or are liable in damages.
2. A director shall not be liable for the acts of his co-directors if he proves that he did not know of the breach of duty before or at the time of its occurrence and that on becoming aware of it after its occurrence he signified forthwith to the co-directors his dissent in writing.
3. The director shall also not be liable for the acts of his co-directors if he proves that, knowing that the co-directors intended to commit a breach of duty, he took all reasonable steps to prevent it.

Prescriptive period in Actions for Breach of Directors' Duties

- The law does not specifically regulate prescriptive periods specifically vis-à-vis directors – so reliance must therefore be placed on the principles regulating prescription in the Civil Code.
- In an action against a director for breach of duties against the company, the proper plaintiff is, as a general rule, the company itself.
- Procedurally, the Courts have adopted the technique of looking at the factual preambles set out in the plaintiff's request, and applying their discretion in characterizing the cause of action.

In **Gaetano Spiteri pro et noe vs Thomas Castle**, it was held that **an action for damages is tortious whenever the damage occurs outside a contractual relationship and is therefore a breach of every man's duty not to harm another.**

- The question of prescription therefore depends:
 1. In the first place on whether there is a pre-existing contractual relationship; and in the case of a director, there clearly is such a relationship, as the director is a mandatary of the company.
 2. In the second place, the question depends on whether the 'fact' of breach is independent and autonomous from the contract. In the case of a director, it is submitted that a breach would usually go to the core of the pre-existing juridical relationship

Emanuel Chircop vs Carmel sive Charles Busuttill (First Hall, Civil Court (2013))

Facts:

- This case concerned an action against a director for breach of duties under Article 136A of the Companies Act.
- The defendant had pleaded the two-year prescription applicable to torts under art.2153 of the Civil Code and the five-year prescription under art.2156 of the Civil Code.

Decision:

- The Court held that art.2153 could not apply on the merits since the relationship of the director to the company is that of a mandatary and emanates from a contractual relationship.
- By excluding tort from the equation, the Court in effect concluded that the applicable prescriptive period would be that based on a contractual relationship.



Provisions exempting officers from liability

Article 148 of the Companies Act provides that any provision *“whether contained in the memorandum or articles of the company or in any contract with a company or otherwise for exempting any officer of the company... from, or indemnifying him against, any liability which by virtue of any rule of law would in the absence thereof have been attached to him in respect of negligence, default or breach of duty or otherwise of which he may be guilty in relation to the company **shall be void.**”*

- An exemption or indemnity clause is certainly void if it is intended to operate in respect of future conduct of the director. Any such clause might have the effect of inducing the director not to satisfy the standards of loyalty, care and skill which the law otherwise demands.
- Notwithstanding the general prohibition against indemnity provisions, a company may indemnify any director against liability incurred by him in defending any proceedings in which judgement is given in his favour or in which he is acquitted.
- Ultimately, notwithstanding the invalidation of exemption and indemnity provisions, a company may purchase and maintain in force, insurance against any such liability for the benefit of its directors, and may pay relative premium out of the company’s finances.
- Alternatively, a policy may be taken out by the director himself so as to be himself indemnified against his own liability to the company or to a third party.

— Duties and liabilities of Directors in financial difficulty



Directors of a company which is in financial difficulty

Article 316 of the Companies Act – WRONGFUL TRADING

“The provisions of this article shall apply where a company has been dissolved and is insolvent and it appears that a person who was a director of the company knew, or ought to have known prior to the dissolution of the company that there was no reasonable prospect that the company would avoid being dissolved due to its insolvency.”

These provisions dealing with wrongful trading feature that:

1. The application may only be brought by the liquidator;
2. It is not necessary to establish fraud or dishonesty;
3. The onus is on the director to prove that he has taken every step with a view to minimising the potential loss to creditors; and
4. The standard of knowledge, skill and experience is tested by the higher of the objective and subjective standards.

Directors of a company which is in financial difficulty

Article 315 of the Companies Act – FRAUDULENT TRADING

*“If in the course of the winding up of a company, whether by the court or voluntarily, it appears that any business of the company has been carried on with **intent to defraud creditors** of the company or creditors of any other person or for any fraudulent purpose, the court on the application of the official receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that **any persons who were knowingly parties** to the carrying on of the business in the manner aforesaid be personally responsible, without any limitation of liability **for all or any of the debts or other liabilities of the company as the court may direct.**”*

Directors of a company which is in financial difficulty

Article 315 of the Companies Act – FRAUDULENT TRADING

However, this provision has a number of conditions which may be seen to have weakened its application:

1. It can only be invoked when the company is in the course of winding up;
2. The applicant will have to discharge the burden of proving that the “business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose”;
3. The official receiver, the liquidator, any creditor and any shareholder may apply for this;
4. The remedies are twofold; the civil remedy imposes liability on directors to pay all the debts of the company and the criminal remedy is contained in Article 315(2).

Conclusion

The role of the directors of a company equates to an office which are of extreme importance to the success of any company. The board of directors forms a fundamental organ of the corporate governance in a modern-day company. As a general rule, it is the board of directors which is vested with all the powers to manage the business of the company. Keeping all this in mind, it is fundamental that directors act bona fide in the interests of the company with the overriding responsibility of the company as a whole.



Questions





www.21Academy.education